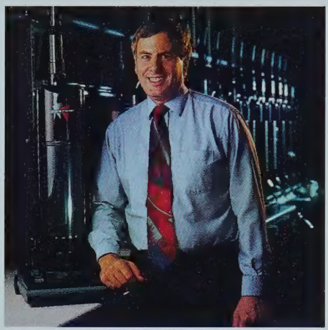
Annual Report

1996

IONA

By any measure, your Company has had an outstanding year – the second in a row – one which has allowed us to expand substantially our sales and profit, solidify our financial position, and improve our manufacturing operations. At the same time, we have acquired new customers and strengthened our relations with existing ones. These events, in turn, have given us the opportunity to set the stage for the next phase of our growth with specific goals in mind.

Report to
Shareholders



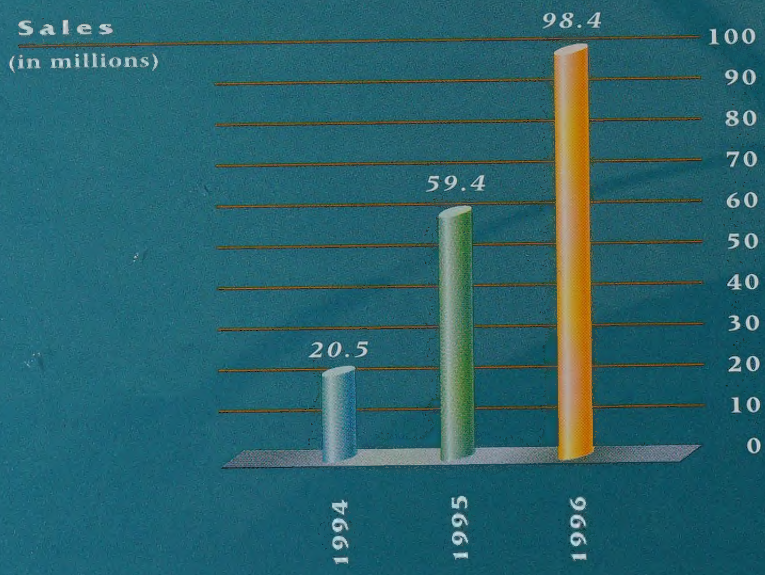
Allan D. Millman
President and
Chief Executive Officer

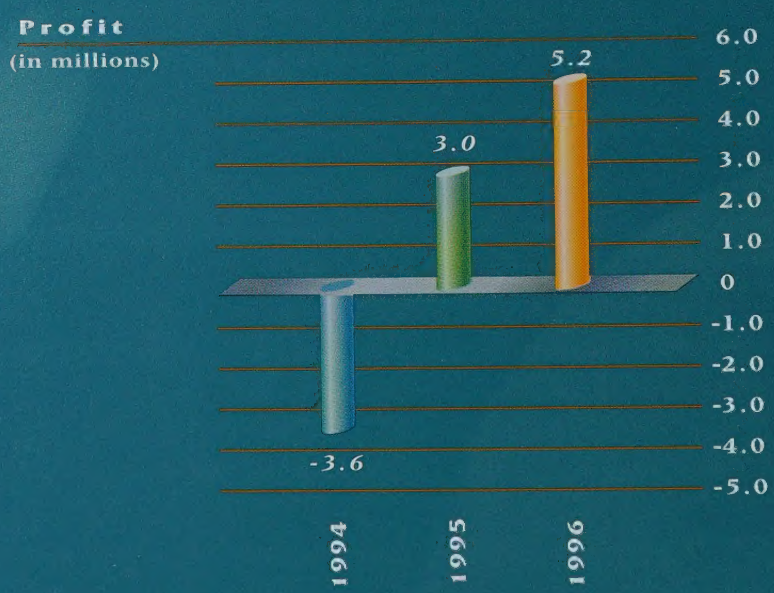
First, Our **Vision**

Our objective is to position the Company within the industry as the leader in the design, manufacture and marketing of innovative, electrical, floor-care products, and to command, within each segment in which we compete, the leading share of market. We plan to achieve this by fully capitalizing on the Company's proprietary, dual-cyclonic, vacuuming technology and by maintaining our commitment to instituting global best-business practices in all functional areas. In addition, all employees will be encouraged to continually develop their decision-making and relationship-building skills.

Our **Financial** Year in **Review**

The Company increased its revenue to $98.4 million, a gain of 66% over last year's volume, and net income reached $5.2 million, an increase of 72% over last year. On a per-share basis, net income reached 72¢ (based on 7.2 million shares outstanding) compared with 48¢ last year (based on 6.3 million shares outstanding). All of this strong showing came from the continuing growth of the FANTOM® vacuum line in the United States, which represented more than 90% of the Company's total volume.





Growing Our **Product Line** For **The Future**

At the beginning of the year, our plan was to strengthen our product line by introducing a new version of the FANTOM® vacuum, and to update our marketing and advertising strategies to support it.

In January, we introduced in the U.S. the brand new 10-amp FANTOM® FURY™ vacuum, a smaller, lighter, lower-priced version of the 11-amp FANTOM® vacuum. This model has been very well received by consumers and retailers alike. And in March, we launched a more powerful 12-amp version of the original FANTOM® vacuum, calling it the FANTOM® THUNDER™ model. With these two introductions, we have tripled our line-up of FANTOM® vacuums.

FANTOM® FURY™
10-amp Vacuum Cleaner

To support the FANTOM® FURY™ launch, we followed the same direct-response, advertising strategy that made the original FANTOM® vacuum so successful, by producing a new 30-minute TV infomercial and two short-form versions of it, one 60 seconds and the other 120 seconds in length. Advertising commenced in February in the United States with excellent response from consumers, the trade and industry watchers. To support the 12-amp FANTOM® THUNDER™ vacuum, we produced two short-form DRTV spots, and these began airing in June.

We also launched the FANTOM® FURY™ vacuum into Canada in March using both the long-form infomercial and two short-form spots. It will take longer to grow the business in Canada as there is no established awareness for FANTOM® vacuums and access to attractively priced infomercial time is limited.

FANTOM® THUNDER™
12-amp Vacuum Cleaner

In keeping with the changes to our product line, we completely updated our FANTOM® consumer packaging on the vacuums and accessories, in order to establish a solid, retail presence using a consistent line image for the brand name and our growing list of products.

In May, we began using data-based marketing to sell our products, another way to reach both past and potentially new customers with new offers. In the future, we intend to increase our emphasis on this way of marketing.

And importantly, throughout the year, we continued to focus on developing new vacuum cleaning products to strengthen our future line.

The **FANTOM® Helpline**

We have continued to expand our special toll-free call centre inside our Welland, Ontario plant to handle inquiries that FANTOM® owners and potential purchasers have about our products. We have done this to help consumers get the best and most accurate information possible by encouraging them to call us directly at the factory. Today, this FANTOM® tele-rep service handles approximately 18,000 calls a month on a wide range of questions. Our market research shows that consumers appreciate this service.

Our **Expanding** Roster of **Blue-Chip Retailers**

Over the past year, a number of major retailers in the U.S. added the FANTOM® vacuum to their line-up of products sold. These include Target Stores; Venture Stores, Inc.; Best Products Co. Inc.; Fred Meyer, Inc.; Penn Daniels Incorporated (Jack's Discount Center); Damark International Inc.; ABC Warehouse; The Anderson Management Corp.; The Caldor Corporation; and Value Vision International, Inc. Our list of well-known retailers carrying the product line also includes Kmart Corporation; Sears, Roebuck and Co.; Home Shopping Network, Inc.; Service Merchandise Company; Montgomery Ward & Co., Incorporated; Tandy Corporation - Incredible Universe Division; JCPenney Company, Inc.; and Fingerhut Companies, Inc. In addition, we sell our products to several hundred independent vacuum dealers who also act as service centers.

In Canada, we have been successful in listing the FANTOM® FURY™ vacuum with the T. Eaton Co. Ltd., Home Hardware Stores Ltd., and The Shopping Channel.

Major **Changes** in How We **Manufacture**

Perhaps the most significant changes in the physical nature of our Company occurred in our manufacturing facility, which had to change to meet the mushrooming demand for FANTOM® vacuums. Early in the year, we made a number of important decisions to free up manufacturing space for the assembly of our principal product line in our Welland plant.

First, we out-sourced most of our U.S. shipping and distribution operations to Sonwil Distribution Center Inc. in Buffalo, NY. Now, as soon as we manufacture the product, we ship it immediately to Sonwil which then takes over. With its outstanding computer, packaging and distribution facilities, Sonwil is capable of a 24-hour turnaround on shipments to anywhere in the United States. We have arranged a similar operation with Livingston Logistic Services Inc. of Etobicoke, Ontario for sales in Canada.

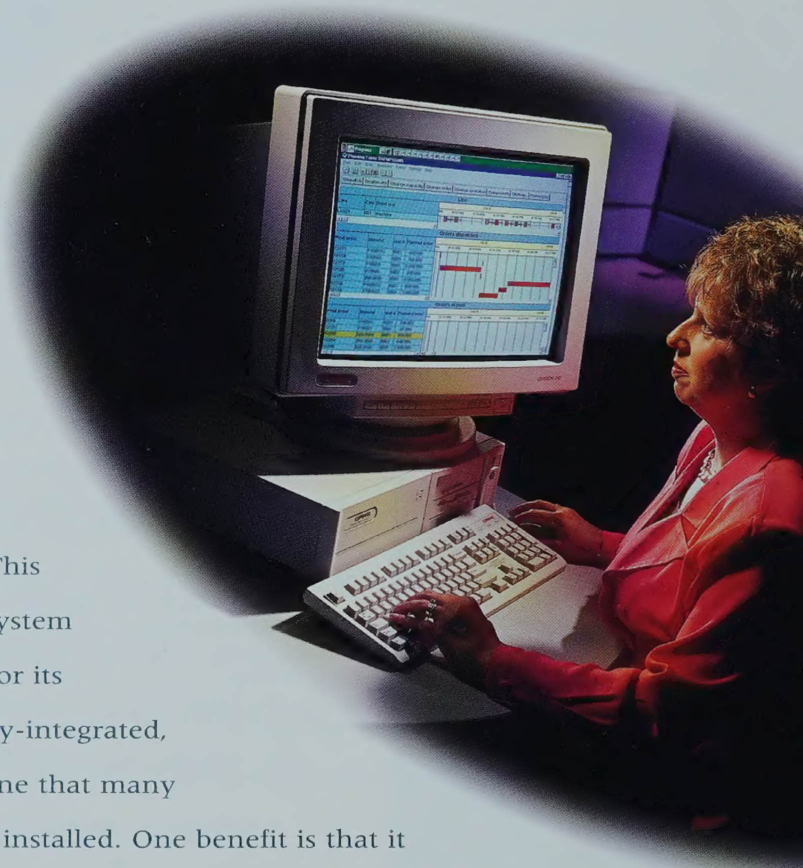
Second, we moved our stick-vacuum production to a satellite location near our assembly plant in Welland. And third, we contracted out the manufacture of one product, and the subassembly of a number of component parts.

As these events were being completed, we also modernized our Welland plant with the goal of creating 'just-in-time' manufacturing on all FANTOM® lines. We installed two state-of-the-art, automated and self-paced assembly lines, which are program-logic controlled, one devoted entirely to the new FANTOM® FURY™ product, the other a swing line capable of producing both the FURY™ and the THUNDER™/original FANTOM® models. With these new assembly lines, we have more than tripled our production capacity.

In addition, we streamlined our component-supplies receiving system to create a 'just-in-time' parts flow, by changing how we accept and store all supplies. And we built a computerized, overhead conveyer system that carries all finished product from the assembly lines to the shipping dock.

In the upcoming year, we intend to make more improvements to our Welland plant.

'Real Time' All The Time



But the most exciting event in our Company – the one with the most far-reaching implications – began on the first business day of our new fiscal year – July 2, 1996. On that date, our Company initiated the 'SAP Enterprise-Resource-Planning System.' This world-class, state-of-the-art system uses Microsoft Windows NT for its operating platform. It is a fully-integrated, business, software package, one that many Fortune 500 companies have installed. One benefit is that it minimizes the time spent carrying out routine activities, thereby shortening the time it takes to complete business transactions as a whole, particularly in the order-delivery time cycle.

For example, with this system in place, we will log an order into the computer the moment we receive it in order entry. Following this, it will be immediately transmitted electronically to every department in the Company: manufacturing, purchasing, distribution, finance, sales, senior management – everyone. Every department will then take responsibility for managing the progress of the order to meet our customers' on-time requirements. Every transaction made on the order along the way will be put into the system, so that everyone on-line is immediately informed of its status. This allows every manager to respond to changes on the progress of the order in the most efficient way possible. This fully integrated system means that we manage the order in 'real time' – that is, information moving constantly into the future towards a final solution – rather than through the traditional, paper-based flow of sequential processing from one department to another. This gives our Company a tremendous advantage over any competitor who is not using a 'real time' system like that of SAP.

Another important feature of this new system is that it maintains 'seamless' financial statements. That is, with every financial transaction that a manager makes during the day, our Company's financial statements – the income statement, the balance sheet, and other important reports – are automatically updated. Your senior executives now have available to them an instant reading of the Company's financial condition, at any moment in the day.

To set up this new advanced system, Iona called upon a number of companies for assistance: GE Capital Technology Management Services (hardware), Sterling Commerce (GENTRAN Server for NT), and SAP Canada, Inc. (SAP software and consulting). In implementing the program, Iona is the first company in the world – in fact, is a world beta-site – for integrating a Sterling EDI-Windows NT solution with SAP.

Equity & Trading Matters

In March, the Company received receipts from both the Ontario and British Columbia securities commissions for its final prospectus dated March 27th, 1996. The prospectus qualified the issue of 1,000,000 common shares of the Company on exercise of 1,000,000 special warrants of the Company previously sold, on a private-placement basis in December, 1995, at $6.00 per special warrant for gross proceeds of $6.0 million. We used the net proceeds from that sale to reduce indebtedness incurred for working capital purposes in connection with the Company's continuing operation.

Also in March, the Company's common shares were approved for quotation and trading on the NASDAQ National Market. Trading is continuing under the trading symbol 'IAAPF' under which Iona's common shares began trading on the NASDAQ SmallCap Market in November 1995.

Ready For the Future

In the past two years, our Company has met the challenge of coping with high growth, and we can see this in the progress of our bottom-line profit. We believe that the recent changes we have implemented in our Company, and others that we plan to make in our new fiscal year, place us in an excellent position to capitalize on many opportunities for more growth in the years to come.

We thank our customers, employees, shareholders and suppliers for their support.

On behalf of the Board,

Kenneth Kelman

Kenneth Kelman
Chairman of the Board

Allan Millman

Allan D. Millman
President and Chief Executive Officer

The FANTOM® Edge

The Company's FANTOM® vacuums all incorporate dual-cyclonic filtering technology. In addition, they feature constant full cleaning power, no filter bags, a see-through collection bin, three on-board attachments, and a certified HEPA filter on their exhaust.

INCREDIBLY VERSATILE
The handle converts to a cleaning wand that stretches to ten feet of reach.

CERTIFIED HEPA AIR FILTER
Captures 99.97% of all particles which flow through it down to 0.3 microns in size.

NO FILTER BAGS
None to buy or replace. Dirt falls into the collection bin which is easily emptied.

CLEANING POWER
Maintains its full cleaning power as it operates. With other vacuums, air flow falls off as the bag fills up.

The **FANTOM® FURY™** *vacuum is powered by a 10-amp, two-stage motor.*

The **FANTOM® THUNDER™** *vacuum generates its power from a 12-amp, two-stage motor.*

This discussion and analysis should be read in conjunction with the financial statements and related notes included in the 1996 annual report to shareholders.

RESULTS OF OPERATIONS

Sales

The Company's sales in fiscal 1996 increased 66% from the previous year to $98.4 million. Because no material price increases were implemented in fiscal 1996, the increase in sales was primarily attributable to increased sales volumes. Shipments to the United States accounted for 95% of total revenue compared to 89% for the previous year. Shipments of FANTOM® vacuums accounted for 94% of total revenue compared with 87% for the previous year.

In January 1996, the Company commenced production and shipments to U.S. retailers of a smaller, lighter version of the original FANTOM® vacuum called the FANTOM® FURY™ vacuum. To support the launch, the Company produced a new 30-minute TV infomercial which commenced airing in February and two short-form TV spots (60 and 120 seconds) which began airing in March. Also in March, the Company began shipping to the U.S. market a more powerful version of the original FANTOM® vacuum called the FANTOM® THUNDER™ vacuum. The Company produced two short-form TV spots (60 and 120 seconds) for this product and they commenced airing in June.

Sales of FANTOM® vacuums (all models) to retailers in the United States in fiscal 1996 increased to $73.4 million from $30.0 million for the previous year. This increase resulted from the introduction of the two new FANTOM® models, from expanded listings and promotional activity, and from the cumulative effect of the Company's direct-response television advertising. Aggregate sales to two major United States retailers – Kmart Corporation and Home Shopping Network, Inc. – were $44.0 million compared with $18.8 million for the previous year.

Direct-response television sales of FANTOM® vacuums were $18.4 million compared with $22.1 million for the previous year and essentially all of these sales occurred in the U.S. Media spending was $6.7 million compared with $7.5 million for the previous year. The decline in advertising was due in part to escalating infomercial media rates and less availability of attractive 30-minute time periods.

The Company introduced the FANTOM® FURY™ vacuum into Canada in March 1996 using both the long-form infomercial and two short-form spots. Advertising expenditures in fiscal 1996 were modest (less than $0.1 million) due to limited access to attractively priced infomercial time and to a lower rate of direct-response sales than experienced in the U.S. The FANTOM® FURY™ vacuum has been listed in Canada by the T. Eaton Co. Ltd., Home Hardware Ltd. and The Shopping Channel.

Selling, General and Administrative Expenses

Selling, general and administrative expenses in fiscal 1996 increased 39% from the previous year but as a percentage of sales declined from 30.7% to 25.8%. Co-op advertising spending (which is advertising controlled by the retailer which includes the supplier's product and for which the supplier agrees to pay a portion of the costs) with U.S. retailers increased from $0.7 million to $3.2 million to support the large increase in sales. Direct-response TV expenses totalled $10.9 million and included $6.7 million for media and $2.1 million for back-end costs associated with in-bound telemarketing, credit card fees, fulfillment and delivery. These compare with media spending and back-end costs of $7.5 million and $2.2 million respectively for 1995.

Cost of Goods Sold

Cost of goods sold for the year ended June 30, 1996, as a percentage of sales, increased to 67.6% from 63.3% in the previous year. This percentage increase was due mainly to a greater portion of sales being to retailers rather than to end-users via direct-response television.

Net Income

The net income for fiscal 1996 was $5.2 million compared with $3.0 million for 1995. The improvement was due mainly to the large increase in sales and the decrease in selling, general and administrative expenses as a percentage of sales. The net income achievement for 1996 includes tax provisions of $0.5 million compared with nil for 1995.

FINANCIAL CONDITION

During the year ended June 30, 1996 there was a cash generation from operations of $1.3 million. Non-cash operating working capital increased by $5.0 million due to increases in accounts receivable and inventory net of increases in accounts payable and accrued liabilities, and this was primarily due to the large increase in sales. Cash in the amount of $6.7 million was provided from equity infusions. On December 6, 1995 Fair Global International Ltd. of Hong Kong exercised warrants to purchase 100,000 Common Shares of the Company at a price of $2.50 per Common Share. On December 20, 1995 the Company received gross proceeds of $6.0 million (of which $3.0 million went into escrow) on the issue of 1,000,000 Special Warrants. The escrowed funds were released on March 29, 1996. Costs of the Special Warrant offering, net of estimated corporate income tax recoveries of $0.2 million, were $0.3 million. On February 5, 1996 B & H Electronics (HK) Ltd. of Hong Kong exercised warrants to purchase 200,000 Common Shares of the Company at a price of $2.50 per Common Share. On April 30, 1996 Newcrest Capital Inc. exercised compensation warrants to purchase 24,000 Common Shares of the Company at a price of $6.125 per Common Share. On May 6, 1996 Sprott Securities Limited exercised compensation warrants to purchase 2,400 Common Shares of the Company at a price of $6.125 per Common Share. An additional $0.1 million of equity was provided from the exercise of outside director and employee stock options.

During fiscal 1996, the Company invested $5.3 million in capital expenditures. These expenditures were mainly for tooling and assembly equipment for the Company's new FANTOM® FURY™ vacuum cleaner, to modernize assembly operations at the Company's Welland plant and to install new information technology.

The Company's net loan payable (loan payable less cash) as at June 30, 1996 was $1.6 million compared with $4.3 million at June 30, 1995. Key ratio's improved from the previous year as follows:

As of June 30	1996	1995
Total Liabilities to Tangible Net Worth	1.14	2.18
Current Assets to Current Liabilities	1.57	1.28

The Company has a credit facility with Commcorp Financial Services Inc. of Burlington, Ontario which presently allows the Company to borrow up to $8.0 million subject to an availability formula based on accounts receivable and inventory. Interest is calculated at the prime rate of a Canadian chartered bank plus 2%. In addition, a service and administration fee, calculated as a percentage of sales, is payable. The Company's borrowings under the facility, which terminates on September 30, 1996, are secured by a registered assignment of book debts, a general security agreement and a mortgage over all of the Company's assets. As at June 30, 1996 the formula provided a borrowing limit of $8.0 million and the Company's loan payable was $2.0 million.

Finance charges during fiscal 1996 increased to $0.7 million from $0.5 million in fiscal 1995. This resulted from the increased loan required to support the higher level of working capital. Service and administration fees paid to Commcorp increased to $0.9 million from $0.7 million.

The Company has arranged a new credit facility with a Canadian chartered bank which will allow the Company to borrow up to $10.0 million for general operating requirements subject to an availability formula based on accounts receivable and inventory, and up to an additional $2.0 million for capital expenditures. Interest will be calculated at the prime rate of the Canadian chartered bank and no service and administration fee, calculated as a percentage of sales, will be payable. The Company's borrowings under this facility will commence on September 30, 1996 upon the termination of the facility from Commcorp and will be secured by a general assignment of book debts, a general security agreement and a mortgage over all of the Company's assets.

OUTLOOK

The Company believes that its FANTOM® vacuum line is continuing to grow in popularity across the United States due mainly to its successful direct-response TV-advertising and to the increasing exposure it is receiving with prominent retailers. Also, consumer research continues to show that FANTOM® vacuums are receiving word-of-mouth endorsements by satisfied customers.

The Company intends to focus on increasing its sales in the United States and Canada by employing the following strategies:

a) Continuing to focus on expanding distribution and promotional activity for its existing models with retailers;

b) Continuing to employ direct-response television to not only generate direct sales but also build broad-scale consumer awareness and demand for FANTOM® products at the retail level;

c) Developing and introducing new vacuum cleaning products in the upright, canister and backpack categories utilizing the Company's proprietary, dual-cyclonic technology.

The Company recently reached agreement with its licensor of dual-cyclonic technology to have its rights in the United States and Canada expanded to include the exclusive right to sell canister and backpack products. Previous agreements provide the Company with the exclusive right (except for a special purpose license to a direct marketing company) to sell upright vacuum cleaning devices utilizing the dual-cyclonic technology in the United States and Canada, and the non-exclusive right to sell upright dry-powder carpet shampooers utilizing the dual-cyclonic technology in the United States and Canada. The expanded rights will allow the Company to develop and sell a broader range of proprietary vacuum cleaning products and to establish a greater presence in the marketplace.

The Company plans to introduce a minimum of two new products in the Fall 1997 - Spring 1998 time frame. It is not possible at this early stage of the development process to forecast sales of these new products or capital requirements with any reasonable degree of accuracy.

The electric floor care industry is highly competitive and includes the following major competitors: Bissell Inc.; Eureka Co.; Hoover Company; Matsushita Electric Works, Ltd.; Philips; and Royal Appliance Mfg. Co. The Company is uncertain how these competitors will react to the Company's increased market share or what effect their reactions might have.

The Company believes it is positioned to realize substantial cost savings as a result of a number of initiatives. These initiatives encompass material price reductions from vendors, productivity gains in assembly, reductions in inventory and improvements in overall efficiencies assisted by the use of the SAP enterprise information technology system which was installed by the Company at the beginning of July, 1996.

Management's Responsibility For Financial Reporting

The accompanying financial statements of Iona Appliances Inc. have been prepared by the management of the Company who are responsible for their integrity and objectivity. To fulfill this responsibility, the Company maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices and accounting and administration procedures are of high quality. The financial information presented throughout this Annual Report is consistent with the information contained in the financial statements.

The Company's Audit Committee is appointed by the Board of Directors annually. This Committee meets annually with management, as well as the independent auditors, to satisfy itself that management and the independent auditors are each properly discharging their responsibilities, and to review the financial statements and the independent auditors' report. The Audit Committee reports to the Board of Directors prior to the Board approving the financial statements for issuance to the shareholders.

The financial statements have been examined by KPMG, the independent auditors, on behalf of the shareholders. Their report outlines the nature of their examination and expresses their opinion on the financial statements of the Company.

Allan Millman

Allan D. Millman
President and Chief Executive Officer

July 30th, 1996

Consolidated Statements of Operations

IONA APPLIANCES INC.

	Year Ended June 30	
	1996	**1995**
Sales	$98,428,527	$59,421,732
Cost of goods sold	66,586,407	37,604,534
	31,842,120	21,817,198
Expenses		
Selling, general and administrative	25,409,225	18,269,770
Finance charges	718,045	523,632
	26,127,270	18,793,402
Income before income taxes	5,714,850	3,023,796
Income taxes (note 8)		
Current	160,000	–
Deferred	344,200	–
	504,200	–
Net Income	5,210,650	3,023,796
Deficit at beginning of year	(4,873,148)	(7,896,944)
Retained earnings (deficit) at end of year	$ 337,502	$ (4,873,148)
Net income per share* (note 11)		
Basic	$ 0.72	$ 0.48
Fully diluted	$ 0.69	$ 0.43

* Net income per share has been calculated using the weighted average number of common and series 1, class A preferred shares outstanding during the respective years. There were 7,232,746 shares for 1996 and 6,302,729 shares for 1995. The number of shares outstanding for purposes of calculating fully diluted net income per share was 7,681,768 for 1996 and 7,179,459 for 1995.

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

IONA APPLIANCES INC.	June 30	
	1996	**1995**
ASSETS		
Current Assets		
Cash in bank	$ 339,768	$ 507,727
Trade accounts receivable	17,204,654	10,481,859
Other receivables	1,709,628	1,090,593
Inventories (note 2)	13,874,909	8,491,763
Prepaid expenses	1,729,954	494,537
	34,858,913	21,066,479
Property, Plant and Equipment, net (note 3)	7,807,926	2,906,847
Deferred Development Expenses at cost less amortization	–	486,298
	$42,666,839	$24,459,624
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Loan payable (note 4)	$ 1,979,858	$ 4,824,322
Trade accounts payable	16,367,895	8,943,688
Other payables and accruals	3,478,668	2,605,846
Income taxes payable	160,000	–
Current portions of capital lease obligations (note 5)	219,036	30,339
	22,205,457	16,404,195
Capital Lease Obligations less current portions (note 5)	378,710	27,337
Deferred Income Taxes	123,200	–
Shareholders' Equity		
Share Capital (note 6)	19,621,970	12,901,240
Retained earnings (deficit)	337,502	(4,873,148)
	19,959,472	8,028,092
	$42,666,839	$24,459,624

Commitments (note 10)
See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

Kenneth Kelman — *Director*

Allan Millman — *Director*

Consolidated Statements of Changes in Financial Position

IONA APPLIANCES INC.

		Year Ended June 30	
		1996	1995
CASH PROVIDED BY (USED FOR):			
Operations			
	Net income	$ 5,210,650	$ 3,023,796
	Items not requiring cash:		
	Depreciation	371,488	282,035
	Amortization of deferred charges	486,298	453,205
	Gain on sale of property, plant and equipment	(17,492)	(98,348)
	Deferred tax provision	344,200	–
	Change in non-cash operating working capital (note 12)	(5,068,068)	(6,676,624)
		1,327,076	(3,015,936)
Financing			
	Proceeds from capital leases	616,480	–
	Payments on capital leases	(76,410)	(24,575)
	Issuance of common shares and warrants	6,720,730	1,718,421
	Deferred tax benefit related to common share issuance	(221,000)	–
		7,039,800	1,693,846
Investments			
	Additions to property, plant and equipment	(5,272,567)	(1,261,265)
	Change in non-cash working capital relating to investments (note 12)	(435,296)	435,296
	Proceeds on disposal of property, plant and equipment	17,492	251,900
		(5,690,371)	(574,069)
	Increase (decrease) in cash position	2,676,505	(1,896,159)
	Cash position at beginning of year	(4,316,595)	(2,420,436)
	Cash position at end of year	$(1,640,090)	$(4,316,595)

Cash position is defined as loan payable less cash in bank.
See accompanying notes to consolidated financial statements.

AUDITORS' REPORT

To the Shareholders
Iona Appliances Inc.

We have audited the consolidated balance sheets of Iona Appliances Inc. as at June 30,1996 and 1995 and the consolidated statements of operations and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at June 30, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG
Chartered Accountants
July 30, 1996

The Company is incorporated under the Business Corporations Act (Ontario). The principal business activities are the design, manufacture and sale of vacuum cleaning devices.

1. SIGNIFICANT ACCOUNTING POLICIES:

These financial statements have been prepared on the basis of accounting principles generally accepted in Canada. The most significant of the policies followed by the Company are as follows:

(a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company's 100% owned subsidiary, Fantom Technologies Direct, Inc.

(b) Inventories:

Inventories are stated at the lower of cost (first-in, first-out method) and net realizable value.

(c) Property, plant and equipment:

Property, plant and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful asset lives at the following rates:

Asset	Rate
Buildings	2.5%
Machinery and equipment	10.0%
Tools and dies	10.0% to 25.0%
Furniture and fixtures	10.0%
Computer equipment	20.0%
Computer software	20.0%

(d) Amortization of computer equipment and software under capital lease:

Amortization of computer equipment and software under capital lease is included in depreciation expense. Such amortization is computed by the straight-line method using a rate of 20% per year.

(e) Deferred development expenses:

Development costs are expensed as incurred until such time as management is reasonably certain that it will be able to commercially exploit the developed product. Deferred development expenses are stated at cost and are being amortized over a five-year period.

(f) Pension costs:

The assets of the pension plans are recorded at market values. The pension expense for the year includes adjustments for plan amendments and experience gains and losses which are being amortized on a straight-line basis over the expected average remaining service life of each plan's participants.

(g) Segmented information:

The Company operates in one industry segment, being the design, manufacture and sale of vacuum cleaning devices and manufactures only in Canada. Sales made to customers located in the United States amounted to $93,190,000 (1995: $52,634,000).

Sales to two customers for the year ended June 30, 1996 amounted to approximately 45 % (1995: 32%) of total Company sales. At June 30, 1996 receivables outstanding from these sales were $8,462,000 (June 30, 1995: $4,951,000).

(h) Foreign currency translation:

The translation of foreign currency balance sheet accounts is performed using current exchange rates in effect at the balance sheet date and for sales and expense accounts using average exchange rates during the period. The gains or losses resulting from translation are included in the results of operations for the period.

(i) Revenue recognition:

Sales and related costs are recorded by the Company upon shipment of products.

(j) Warranties:

The Company records a warranty accrual at the time of sale for estimated claims. The warranty on the Fantom products is for two years. The warranty on other products is generally for one year. It is the Company's practice to classify the entire warranty accrual as a current liability.

2. INVENTORIES:

Inventories are summarized as follows

	1996	1995
Raw materials and work-in-process	$ 7,575,710	$5,637,555
Finished goods	6,299,199	2,854,208
	$13,874,909	$8,491,763

3. PROPERTY, PLANT AND EQUIPMENT:

			1996	1995
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Land	$ 81,204	$ –	$ 81,204	$ 81,204
Buildings	738,692	156,773	581,919	473,038
Machinery and equipment	1,918,363	294,104	1,624,259	110,231
Tools and dies	5,373,365	2,027,795	3,345,570	1,075,685
Furniture and fixtures	602,810	152,858	449,952	121,932
Construction in progress	1,038,498	–	1,038,498	962,533
Computer equipment and software under capital lease	738,295	51,771	686,524	82,224
	$10,491,227	$2,683,301	$ 7,807,926	$2,906,847

4. LOAN PAYABLE:

During 1994, the Company entered into a financing agreement with International Mercantile Financial Ltd. which permitted the Company to borrow through September 30, 1996 up to a maximum of $4,000,000 subject to total borrowings not exceeding a calculated amount based on accounts receivable and inventory. During 1995, this maximum was increased to $6,000,000 and on August 4, 1995 the maximum was increased to $8,000,000. In February of 1996 the rights and liabilities of International Mercantile Financial Ltd. with respect to the Company were assigned and transferred to Commcorp Financial Services Inc. At June 30, 1996 the unused amount available under the facility was $6,020,142 (June 30, 1995; $1,175,678). Interest is calculated at the prime rate of a Canadian chartered bank plus 2%.

The interest rate on the loan payable at June 30, 1996 was 8.50% (June 30, 1995: 10.9%).

The effective interest rate on the loan payable for the year ended June 30, 1996 was 9.50% (1995: 11.5%)

During the term of the agreement a service and administration fee, calculated as a percentage of sales, is also payable. This fee for the year ended June 30, 1996 was $897,000 (1995: $673,000) and is included in selling, general and administrative expenses.

The borrowings under the agreement are secured by a registered assignment of book debts, a general security agreement and a mortgage over all assets.

5. CAPITAL LEASE OBLIGATIONS:

Future minimum lease payments, by year and in aggregate, under capital leases are as follows:

	1996	1995
Fiscal year:		
1996	$ –	$ 39,752
1997	256,111	29,814
1998	229,311	–
1999	172,912	–
2000	3,014	–
Total minimum lease payments	661,348	69,566
Amount representing interest (at rates of 9.26% to 22%)	63,602	11,890
Present value of net minimum lease payments	597,746	57,676
Less current portions	219,036	30,339
	$ 378,710	$ 27,337

6. SHARE CAPITAL:

(a) Capital Stock:

The authorized share capital of the Company consists of an unlimited number of common shares, an unlimited number of class A, preferred shares, issuable in series, of which 1,581,748 (1995:1,764,706) series 1, non-redeemable, non-retractable convertible class A preferred shares have been issued and an unlimited number of class B, preferred shares, issuable in series.

The issued share capital of the Company is as follows:

	June 30	
	1996	1995
Common shares (note 6(b))	$17,719,712	$10,775,951
1,581,748 (1995: 1,764,706) series 1, Class A, preferred shares	1,902,258	2,122,289
Warrants for common shares (note 6 (b))	–	3,000
	$19,621,970	$12,901,240

The series 1, class A preferred shares are fully convertible into common shares of the Company on a share-for-share basis, subject to comprehensive anti-dilution protection for the holders of the series 1, class A preferred shares and are entitled to receive dividends equally and ratably with the common shares. At June 30, 1996, the 1,581,748 series 1, class A preferred shares are convertible into 1,598,915 common shares. Mandatory conversion is required on May 1, 2000 if the market price per share exceeds a base price.

(b) Changes in common shares:

	Shares	Amount
Outstanding at June 30, 1994	3,791,750	$ 9,051,530
Shares issued from treasury for cash	300,000	679,080
Exercise of warrants	900,000	981,816
Exercise of stock options	57,750	63,525
Outstanding at June 30, 1995	5,049,500	10,775,951
Conversion of preference shares to common shares	184,943	220,031
Exercise of warrants	300,000	753,000
Shares issued from treasury for cash (note 6(c))	1,000,000	5,668,755
Exercise of Compensation Warrants	26,400	161,700
Exercise of stock options	102,250	140,275
Outstanding at June 30, 1996	6,663,093	$17,719,712

On October 3, 1994, 300,000 common shares and warrants to purchase an additional 300,000 common shares were issued from treasury for net proceeds of $679,080. Consideration attributed to the warrants was $3,000. On December 6, 1995, 100,000 warrants were exercised for proceeds of $250,000. On February 5, 1996, the remaining 200,000 warrants were exercised for proceeds of $500,000.

Warrants had been issued to the holders of the series 1, class A preferred shares to purchase 900,000 common shares at a price of $1.084241 per share. Consideration for these warrants was $9,000. On August 3, 1994, 450,000 of these warrants were exercised for net proceeds of $484,908. On April 27, 1995, 450,000 of these warrants were exercised for net proceeds of $487,908.

(c) Special warrants:

On December 20, 1995, the Company issued and sold 1,000,000 special warrants of the Company for gross proceeds of $6,000,000 pursuant to an underwriting agreement between the Company, Sprott Securities Limited and Newcrest Capital Inc. (collectively, the "Underwriters"). Subsequent to receipt of the final prospectus by the securities regulatory authorities on March 27, 1996, the special warrants were exercised and 1,000,000 common shares were issued. Costs of the offering, net of estimated corporate income tax recoveries of $221,000, were $331,245.

Under the agreement the Underwriters received a fee of $360,000 and 60,000 common share purchase warrants (the "Compensation Warrants"). Each Compensation Warrant entitles the holder thereof to purchase one common share of the Company at a price of $6.125 per share. The exercise period expires on March 27, 1997. At June 30, 1996, 33,600 Compensation Warrants are outstanding.

(d) Stock option plans:

The Company has reserved 130,000 common shares pursuant to a Key Employee Incentive Stock Option Plan. The Board of Directors reserved an additional 100,000 shares under the Key Employees' Stock Option Plan approved by the shareholders on October 20, 1994. Options to purchase common shares of the Company under the Plans may be granted by the Board of Directors to certain employees of the Company. The Company has reserved 180,000 common shares pursuant to an Outside Director Share Option Plan.

The Company has reserved 10,000 common shares pursuant to an option granted to an independent consultant.

The Company has reserved 40,000 common shares pursuant to an arrangement with Brean Murray, Foster Securities Inc.

The exercise price for the common shares covered by the foregoing option arrangements is determined by the Board of Directors, but must not be less than the fair market value of the common shares at the time of the grant of the option.

Stock option plans continued...

Changes in the outstanding stock options relating to the plans.

	Number of Shares	Option Price Range Per Share
Outstanding at June 30, 1994	248,250	$1.10
Granted	65,000	$2.70 to $4.80
Cancelled	(12,500)	$1.10
Exercised	(57,750)	$1.10
Outstanding at June 30, 1995	243,000	$1.10 to $4.80
Granted	90,000	$5.00 to $8.50
Cancelled	(3,250)	$2.70
Exercised	(102,250)	$1.10 to $3.90
Outstanding at June 30, 1996	227,500	$1.10 to $8.50

The outstanding options have an average exercise price of $3.75 and expire at various dates in the period from September 9, 1996 to January 12, 2001.

7. PENSION PLANS:

The Company maintains two defined benefit pension plans which cover substantially all of its employees. The pension expense for the year ended June 30, 1996 was $224,000 (1995: $137,000). As at June 30, 1996 the accrued benefit obligation was approximately $3,797,000 (June 30, 1995: $2,913,000) and the market value of pension fund assets was $3,837,000 (June 30, 1995: $3,260,000).

8. COMPONENTS OF CONSOLIDATED INCOME TAXES:

	1996	1995
Provision based on statutory combined federal and provincial income tax rates (1996: 44.3%, 1995: 44.3%)	$ 2,531,200	$ 1,340,000
Manufacturing and processing profits deduction	(274,000)	(140,000)
Recognition of tax benefits not previously recognized	(1,913,000)	(1,200,000)
Provincial minimum tax	160,000	–
	$ 504,200	$ –

9. RELATED PARTY TRANSACTIONS:

Included in other payables and accruals are advances of $ NIL (June 30, 1995: $435,296). These advances were non-interest bearing, due and repaid on February 5, 1996 and were guaranteed by a shareholder.

10. COMMITMENTS:

(a) Under various technology transfer agreements, the Company has an obligation to pay royalties based upon sales of products using dual-cyclonic technology. In some instances, the Company must pay a minimum annual royalty in order to preserve the exclusive nature of its rights. Minimum royalty payments for fiscal 1997 amount to approximately $250,000. The agreements extend until the basic patents expire with bi-annual adjustments in the royalty rate based on the change in the consumer price index. The first of the basic patents does not expire until 2003.

(b) At June 30, 1996 the Company has committed to spend $383,000 for equipment and tooling.

11. NET INCOME PER SHARE:

Basic net income per share has been calculated using the weighted average number of common and series 1, class A preferred shares outstanding during the respective years. These were 7,232,746 shares for 1996 and 6,302,729 shares for 1995.

The 1996 net income for the calculation of fully diluted net income per share has been increased by $63,000 (1995: $76,000) being the after-tax effect of the investment at 9% of the proceeds of the exercise of the stock options and warrants mentioned in note 6, and assuming that the exercise occurred at the later of the beginning of the year and the issue date. The number of shares outstanding for purposes of calculating fully diluted net income per share was 7,681,768 for 1996 and 7,179,459 for 1995.

12. CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION:

Changes in non-cash operating working capital are as follows:

	1996	1995
Trade accounts receivable	$(6,722,795)	$(7,297,360)
Other receivables	(619,035)	(573,525)
Inventories	(5,383,146)	(3,444,808)
Prepaid expenses	(1,235,417)	(237,431)
Trade accounts payable	7,424,207	4,459,118
Other payables and accruals	872,822	852,678
Income taxes payable	160,000	–
	$(5,503,364)	$(6,241,328)
Relating to operating activities	$(5,068,068)	$(6,676,624)
Relating to investing activities	(435,296)	435,296
	$(5,503,364)	$(6,241,328)

Directors & Officers

IONA APPLIANCES INC.

DIRECTORS

Arthur H. Crockett	Toronto, Ontario, Corporate Director
Maxwell Goldhar	Toronto, Ontario, Corporate Director
Kenneth Kelman	Toronto, Ontario, Chairman of the Board of the Company
Rikki Meggeson	North York, Ontario, Corporate Director
Allan D. Millman	Toronto, Ontario, President of the Company
C. George Scala	Beverly, Massachusetts, Corporate Director
Alan Steinert, Jr.	Cambridge, Massachusetts, Chief of Staff of Health and Human Services of the Commonwealth of Massachusetts

OFFICERS

Kenneth Kelman	Toronto, Ontario, Chairman of the Board
Allan D. Millman	Toronto, Ontario, President and Chief Executive Officer
William G. Birdsall	St. Catharines, Ontario, Treasurer
Alan C. Hussey	Welland, Ontario, Vice President, Manufacturing
Walter J. Palmer	Toronto, Ontario, Secretary
Joseph A. Shillington	Welland, Ontario, Vice President, Information Systems
Norman V. Soler	Port Colborne, Ontario, Vice President, Engineering
Nick E. Varanakis	Sandy, Utah, Vice President, Sales - United States
Linda L. Watson	Mississauga, Ontario, Vice President, Marketing

IONA APPLIANCES INC.

Head office and manufacturing facility: *1110 Hansler Road, P.O. Box 1004, Welland, Ontario L3B 5S1 905-734-7476*

Toronto sales office: *Suite 414, 1 Eva Road, Toronto, Ontario M9C 4Z5 416-622-9740*

Auditors: *KPMG, Commerce Place, 21 King Street West, Suite 700, Hamilton, Ontario L8N 3R1*

Lender: *Commcorp Financial Services Inc., 5050 South Service Road, Burlington, Ontario L7R 4C8*

General Counsel: *Fasken Campbell Godfrey, Suite 3600, Toronto-Dominion Centre, Toronto, Ontario M5K 1N6*

Transfer Agent & Registrar: *R-M Trust Company, 393 University Avenue, 5th Floor, Toronto, Ontario M5G 1E6*

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ANNUAL SHAREHOLDERS MEETING

October 24, 1996, Belgravia Room, The King Edward Hotel, 37 King St. East, Toronto, Ontario at 11:00 a.m.

IONA®

Head Office: 1110 Hansler Road, P.O. Box 1004, Welland, Ontario, Canada L3B 5S1
Tel: (905) 734-7476 Fax: (905) 734-9955 Internet address: fantom@fantom.com